

## IS YOUR LLC AN ASSET PROTECTION TRAP?

Limited liability companies (LLCs) are wonderful devices for protecting personal assets from creditors. LLCs, however, can sometimes be a trap for persons intent on protecting their assets from creditors.

LLCs are generally better than corporations for protecting assets. Most state LLC statutes expressly limit the liability of individual members for business debts of the LLC itself. However, many courts will “pierce the veil” of corporations to allow creditors to chase assets of the shareholders, especially where courts believe the corporation to have been intentionally undercapitalized or where “corporate formalities” such as holding annual meetings have not been observed.

LLC statutes also generally prevent courts from using the failure to maintain entity formalities as a reason for “piercing the veil.” In addition, creditors have much more difficulty in satisfying a debtor’s debts from equity interests in an LLC. In most states, creditors can only obtain a lien upon the “distributional interest” of the debtor’s equity in an LLC, rather than the equity itself.

LLCs, though, have certain limitations in their usefulness as asset protection vehicles. Individuals who use LLCs for these purposes may overestimate how “bullet-proof” these LLCs really are. Fortunately, these traps can generally be avoided by the knowledgeable attorney.

The most serious traps involve the careless use of “single-member LLCs” (“SMLLCs”), or LLCs which have only one owner. SMLLCs are commonly used by planners to hold assets, which would otherwise be owned by persons in their own names. For example, SMLLCs are commonly used by asset protection planners to protect investment portfolios, equity interests in operating companies, and investment real estate from creditors. An SMLLC does not require the asset-owning individual to surrender any control over these kinds of assets, a shortcoming of many other asset protection devices.

Unfortunately, courts in some states, Florida being a leading example, have now been willing to “pierce the LLC veil” in some circumstances involving SMLLCs, and thereby allowing creditors of the LLC to pursue assets of the LLC’s single member. This trend may well be matched by judicial willingness to allow creditors of LLC members to force sales of membership interests in LLCs. For these reasons, choosing an appropriate state for the organization of an LLC (particularly if it will be an SMLLC) is extremely important. The LLC statutes in some states, such as Nevada, incorporate protections for the owners of single-member LLCs, and the courts of those states seem highly likely to respect these protections.

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